

**STATEMENT OF**  
**William C. Erbey Chairman and Chief Executive Officer**  
**Of**  
**Ocwen Financial Corporation**  
**BEFORE THE**  
**Subcommittee on Housing and Community Opportunity Hearing**  
**HEARING ON**  
**Loan Modifications:**  
**Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?**  
**February 24, 2009**

***Introduction***

Chairwoman Waters, Ranking Member Capito and distinguished Members of the Subcommittee -- my name is William Erbey and I am Chairman and CEO of Ocwen Financial Corporation, an independent mortgage loan servicer.

First, let me thank you for the opportunity to participate in this hearing today. I share your sense of urgency to find a lasting solution to our daunting foreclosure crisis -- a crisis that lies at the very heart of our nation's economic problems and threatens millions of families with the loss of their American Dream -- their home.

I applaud the leadership of the Chairwoman and Subcommittee Members in relentlessly advocating -- ever since the inception of the crisis -- the need for bold action to assist homeowners with unaffordable mortgages and to prevent avoidable foreclosures.

***Ocwen Supports the President's Homeowner Affordability and Stability Plan***

I also applaud President Obama, Secretary Geithner and the President's economic team for answering the call for bold action -- in a matter of just a few weeks into the new Administration -- by launching the **Homeowner Affordability and Stability Plan**. This Plan includes a substantial loan modification component, the subject of today's hearing.

Prior government-sponsored loan modification initiatives were all good first steps in the right direction, but the President's new Plan is exactly the kind of **insightful and decisive action** that is needed to make a material impact on the foreclosure crisis.

***Ocwen's Commitment to Foreclosure Prevention Through Loan Modifications – A Win/Win/Win Solution for Homeowners, Lenders and Servicers***

As one of the few remaining independent mortgage servicers, Ocwen is very proud of our achievements in foreclosure prevention through loan modifications. We are not a loan originator -- we do not make mortgage loans. Rather, Ocwen is engaged as loan servicer under contract with mortgage investor-owners, i.e., the securitized REMIC trusts in which loans have been pooled by the mortgage-backed securities industry. Currently, our servicing portfolio contains approximately 325,000 mortgage loans, of which approximately 85% are subprime.

Beginning in early-2007, we pro-actively prepared for an increase in mortgage delinquencies by increasing our Home Retention Consultant staff by 50%. When the mortgage meltdown hit with full force later that year, we increased staff by another 35% and were the first in the industry to adopt an aggressive and comprehensive **loan modification program**. Our program re-engineers lower mortgage payments that are both **(a) affordable by the homeowner and (b) will return greater cash flow to investors than the net proceeds that would otherwise be realized in a foreclosure**.

Loan modifications crafted in this way are consistent with our contractual obligations and result in a **win/win/win** solution for all involved. The homeowner keeps their home; the loan investor avoids a substantial loss; and the loan servicer retains the loan in its servicing portfolio. Since the inception of the crisis, we have saved **over 90,000 homes** from foreclosure. And for investors, Ocwen's loan modification program returns **the highest cash flows** by any servicer on 90+ days delinquent loans – an amount that is **twice the industry average** – according to a Credit Suisse industry report. See "Mortgage Servicing Update," Credit Suisse, September, 2008.

Ocwen has been recognized by industry participants, regulators, community advocacy groups and the media as a leader in foreclosure prevention through loan modifications. See, e.g., "Forestalling Foreclosure," TIME Magazine, December 31, 2008; "Modifying Mortgages Can Be a Tricky Business," New York Times, February 19, 2009 (copies attached).

***Ocwen's success in sustainable loan modifications – "re-default" rate is less than half the OCC/OTS reported average***

If loan modifications are to have an enduring impact, the reduced mortgage payments must be **sustainable** by homeowners. The salient measure of success, therefore, is the "re-default" rate, i.e., the percentage of loans that go into default again after modification. We are pleased to report that loan modifications engineered by Ocwen have a re-default rate of **19.4% compared to an industry average 42.9%** according to the most recent report issued by the OCC and OTS.

***“Customized” loan modifications including Principal Reductions coupled with Early Intervention are the key to minimizing re-defaults***

The superior sustainability of Ocwen’s loan modifications is the result of our **customized approach** that addresses homeowner delinquencies on a loan-by-loan basis. By combining our proprietary loan analytics technology with behavioral science research, we:

- **First**, comprehensively re-underwrite each delinquent loan we service (i.e., the way it should have been done by the broker or lender at origination);
- **Second**, we determine whether modification is both affordable by the homeowner on a sustainable basis and maximizes net present value (or “NPV”) for the loan owner as compared to a foreclosure; and
- **Third**, we provide one-on-one financial counseling to the homeowner, aided by interactive scripting engines incorporating proven psychological principles of persuasion and commitment, to maximize the likelihood of keeping current on the modified terms.

Another key to sustainability is **principal reductions** where necessary to achieve affordability. **18.7% of our loan modifications include writing down the loan balance** – this allows us to help more distressed homeowners with more solutions. An authoritative industry report noted that Ocwen leads the industry with **70% of the industry’s principal reduction modifications**. See “Subprime Loan Modifications,” Credit Suisse, October 1, 2008.

**Early intervention** is critical to foreclosure prevention. Prevailing industry standards, as confirmed by the American Securitization Forum, make clear that it is permissible to modify loans not only when the borrower is actually in default, but also when default is **imminent or reasonably foreseeable** in the good faith judgment of the servicer. Adopting this standard, our Early Intervention unit has successfully avoided upwards of **9,000 foreclosures** through pro-active modifications.

***Resolving delinquencies in the best interest of the investor/taxpayer – the net present value calculation***

The NPV model typically employed by loan servicers is limited to a static “point-in-time” approach that makes no attempt to account for the likely borrower behavior post modification (e.g., re-default, prepayment probability) or the likely value of property over time. Nor does the typical NPV model have the ability to analyze the *joint* probabilistic impact of several variables such as interest rate, step period and term.



In contrast, Ocwen utilizes a proprietary NPV model based on a **more dynamic “continuum” approach** -- one that incorporates a robust suite of cash flow models, statistical models and optimization algorithms that together produce truly optimal resolutions for investors/taxpayers. Our NPV calculations are based on the following:

- **Probability of Success Post Mod Model**
  - Assesses probability over time of staying current post modification
- **Probability of Prepayment Post Mod Model**
  - Assesses probability over time of pre-paying post modification
- **Case Shiller Home Price Index Prediction Model**
  - Time series and regression models that predict HPI for next 5 years
- **Optimization Algorithm**
  - Non-linear mixed integer models that can evaluate multiple vectors to determine the optimal combination of modified loan terms to maximize NPV

***Scaleable technology is needed to meet the heavy volumes of delinquencies***

If a loan modification program is to have a **material impact** to redress the national foreclosure crisis, it must be **scalable**. We have invested over **\$100 million in R&D** in building an automated large scale system that incorporates artificial intelligence, decisioning models and scripting engines. This robust technology allows us to take on **many multiples** of the volumes of delinquencies we have already cured in our portfolio.

***Consumer advocacy groups have been instrumental in enhancing borrower outreach***

I would be remiss if I didn't recognize the critical assistance provided to us by our **non-profit consumer advocacy partners**. When for whatever reason a homeowner in distress does not respond to our letters or phone calls, we are unable to help them. Through grass roots outreach and educational initiatives, community groups such as the National Training and Information Center, HomeFree-USA, National Fair Housing Alliance, National Association of Neighborhoods, National Council of La Raza, St. Ambrose Housing Aid Center, East Side Organizing Project, South Brooklyn Legal Services, Homeownership Preservation Foundation, Neighborhood Assistance Corp. of America, Homes on the Hill, Neighborhood Housing Services of Chicago, Dominion Community Development Corp., Pittsburgh Community Reinvestment Group, Project to End Predatory & Deceptive Real Estate Practices at the Community Law Center and so many others have greatly assisted us in making that key communication link with our customers. We have also recently established a relationship with the National Community Reinvestment Coalition to broaden our homeowner outreach, and we will continue to support the foreclosure prevention efforts of HOPE NOW Alliance.



*Enhancement to the Homeowner Affordability and Stability Plan: Assisting Loan Servicers With Advance Financing*

A key aspect of the current credit crisis is the absence of financing for servicer “advances” that servicers are required to make to the MBS Trusts holding loans they service when borrowers miss P&I payments. Advances are paid back to the servicer from the top of the waterfall (i.e., ahead of the AAA bondholders) and are well collateralized by the value of the housing stock securing the mortgages in the Trust. At any point in time, the amount of advances due to the servicer is less than 5% of unpaid principal balance of the Trust. Even though advances have zero credit risk and financing them is the equivalent of a 5% LTV loan, the large commercial banks who have traditionally provided this financing have all but withdrawn from the market, including those who have received tens of billions in TARP money.

Perverse incentives are created due to lack of advance financing. For a servicer to work out a modification for a delinquent borrower, the foreclosure timeline must be extended. But this means the servicer must make additional advances during the workout period. Further, advances previously made on a foreclosed home are often not reimbursed to the servicer until the REO is sold. The incentives for the servicers are therefore to expedite, rather than forestall, the foreclosure process and then to dump the REO on the market by slashing price to ensure a quick sale. This puts more families out of their homes and exacerbates the decline in home prices which in turn precipitates more delinquencies, more foreclosures, and the vicious cycle continues unabated.

***Two Proposed Solutions for Advance Financing***

There are at least two currently proposed initiatives to provide servicer advance financing. Each can be funded and implemented simultaneously – they are not mutually exclusive.

1. **Independent Mortgage Servicers Coalition:** Various proposals to the Federal Reserve, Treasury and FHFA to provide up to \$8 billion in a short-term financing facility and/or a related guarantee for to independent loan servicers who, combined, service in excess of \$600 billion in mortgages (over four million homes).
2. **Robert Johnson/Urban Trust Bank (“UTB”):** Proposal for government infusion of up to \$1 billion in minority-owned UTB to establish a new operating division to provide advance financing to servicers who commit to aggressive foreclosure prevention and loan modification measures. UTB would repay the entire investment over time, along with a 5% annual dividend. Mr. Johnson would assist servicers with homeowner outreach to minority communities hardest hit by the foreclosure crisis.

## ***Conclusion***

Let me conclude by saying that, as the President and Congress work together to combat the economic crisis, **Ocwen is ready, willing and able to help**. We are delighted to have been selected by Freddie Mac to pilot a special loan modification program, and we have additional capacity to assist in similar programs. Ocwen and other independent loan servicers are the front line of the fight against home foreclosures, and we have the most potent ammunition to win the battle – customized, scaleable loan modifications.

I thank you again for inviting me to testify today. I will answer any of your questions and I ask that my full written statement be entered into the record.

REAL ESTATE

# Forestalling Foreclosure

A subprime servicer has devised a plan for modifying loans to keep people in their homes

BY BARBARA KIVIAT

**I**F YOU THINK SUBPRIME LENDERS ARE the loan sharks of real estate, then loan servicers—the outfits that collect mortgage money and run the books—are the enforcers. Their job is to keep the dough coming, no matter what. Yet Ocwen, one of the nation's largest servicers of subprime loans, has rewritten its role as the heavy and may have an approach to modifying delinquent loans that could slow the wave of foreclosures undermining the economy.

Last year, nearly a million houses were lost to foreclosure. That number could easily rise by millions over the next few years, promising more economic pain. The big problem is that no one has figured out a systematic way to stop the rot. Federal agencies and private lenders have rolled out one loan-modification program after another—scattershot and largely timid attempts to make existing mortgages more affordable and keep neighborhoods intact.

Then there is Ocwen, which has already revised 16% of its 340,000 mortgages, in many cases cutting monthly payments 20% to 40%. Based in West Palm Beach, Fla., the company handles some of the worst loans Wall Street kicked up during the housing boom and isn't about to win any popularity contests among consumers—in the past, it's been the target of complaints about unresponsiveness and excessive fees. Nevertheless, good ideas can come from unlikely places, and as more borrowers—including a growing number with prime loans—fall behind on payments, there are lessons to be learned from the firm that has done more than almost anyone else to keep struggling homeowners in their houses.

Executives at Ocwen used to think, as those at any mortgage servicer would, that the solution to a delinquent loan was to create a plan for homeowners to catch up on past payments. When house prices were rising and refinancing was easy, that generally worked, even though it often meant higher monthly payments. But in early 2007, as housing values plateaued, then plummeted, Ocwen saw the percentage of homeowners defaulting a second time climb from 25% to 36%. "We realized we were going to have to make some adjustments," says Ocwen president Ron Faris.

So the company reprogrammed its computer models, which determine how to extract the most value from each loan, to allow much more substantial changes—lowering a mortgage's interest rate, docking its principal balance, converting an adjustable rate to a fixed one, stretching out the life of a loan. With many mortgages "upside down" (when the loan is larger than the home's current value) and the economy sagging, changes often have to be drastic to make the math work, but Ocwen has largely found a way, devising an affordable payment plan 90% of the time.

What really sets Ocwen apart, though, is its vigor. From doing just a couple of hundred modifications a month in the first half of 2007, Ocwen was up to 4,000 a month by the beginning of 2008, with 77% involving a reduction of the interest rate and 20% including a permanent write-down of the principal balance. Is it working? Six months after receiving an Ocwen modification, 21% of homeowners have again fallen behind on their payments by

60 days or more. That compares with a 37% redefault rate nationally, according to data from federal regulators—a figure that also includes much more stable prime loans.

Principal write-downs are practically unheard of elsewhere—even though they might very well be the best long-term solution for people who owe more than their mortgage is worth, and they help the broader picture too. "That debt overhang is a big drag on the economy," says Alan White, a Valparaiso University professor who studies loan modifications.

The motivation for modification isn't so much social responsibility as the pursuit of profit; when loans go delinquent, the servicer makes less money. Most of Ocwen's business is in collecting on subprime loans, so its portfolio has been hit hard. Nearly a quarter of the loans it services were behind in November, up from just 8% at the end of 2006. And while Ocwen doesn't own those loans, it still loses out when people don't pay on time, since the company has to temporarily front money to investors to make up for the shortfall. "Despite the fact that they're doing it in their own interest, you can't dismiss it," says Rod Dubitsky, head of asset-backed-securities research at Credit Suisse, whose assessments show that aggressive modifications keep people in their homes longer.

Ocwen has also answered a key question for other would-be modifiers: whether it's possible to pass major losses to investors without getting sued. Paul Koches, Ocwen's general counsel, holds that the company is not obliged to take such steps but obligated to—if that's what

## Doing the Math on Loan Modifications

If you're struggling to make your mortgage, getting a break on payments probably sounds great. But will your servicer want to help? Here's how it all plays out

**1 A homeowner misses a payment.** As the economy flags, people have less income. House prices are depressed, so refinancing out of trouble is no longer an option.



**2 The mortgage servicer notices.** First you'll be asked to make up the amount you missed. If your dip in income is temporary, don't expect much more.







**John and Susan Archon** *Wellington, Fla.*

Ron Faris, president of the loan servicer Ocwen, tosses a foreclosure sign. The Archons, right, fell behind on their mortgage after John's paycheck—he's a manager at a roofing company—took a major hit. Ocwen calculated that foreclosing on them would be less lucrative than lowering the interest rate on their mortgage, thus dropping their payments by \$500 a month—enough to keep them in the house

it takes to squeeze the most money out of a loan for the long term. That's the case executives make when angry investors call—and they do call, especially when a principal reduction chokes off cash flow in a particular month.

Make no mistake: Ocwen has a nearly messianic focus on the goal of maximizing returns for investors. "In most cases, that means keeping people in their homes and

getting them to pay their mortgages," says Ocwen CEO Bill Erbey. In foreclosure, investors typically recoup only 60¢ on the dollar.

In a way, Ocwen was uniquely situated to jump ahead on modifications. Erbey, who used to run General Electric's mortgage-insurance operation, started buying nonperforming loans with his partners in the early 1990s. Ever since, Ocwen has been refining its computer models—we're talk-

ing sophisticated stuff, like vectors and artificial intelligence—to better whip delinquent loans into shape. When the housing slump hit and defaults started to rise, Ocwen wasn't some afterthought unit of a mortgage originator caught with its pants down; it was in its element, in a position to immediately scale up.

That's why, unlike a lot of loan-modification programs, such as those rolled out by Citigroup and IndyMac Bank, Ocwen's doesn't use broad guidelines—for instance, assuming that homeowners should be able to contribute 38% of their income to paying their mortgage. When Ocwen rewrites a loan, it starts from scratch, with an agent at one of its four call centers—two in Florida, two in India—following an adaptive script to reconstruct a borrower's financial data. (The script changes, based on not only what a borrower says but also how he says it; since hiring a director of consumer psychology last summer, Ocwen has been handling embarrassed callers differently than, say, angry ones.)

"I had to show why I was making less money," says John Archon, a manager at a roofing company in Florida, whose paycheck took a major hit in the housing bust. He and his wife now share a car, are energy conscious and "eat a whole lot more hamburgers than steak." Ocwen knocked the interest rate on their 30-year fixed-rate mortgage from 9.3% to about 6.9%, saving the couple \$500 a month. Getting those new terms was a stressful process, says Archon, but he "took the standpoint that they were weeding out the people who were not that serious."

Ocwen also breaks ranks with industry practice by modifying loans for people who bought houses as investments. Again, that's in Ocwen's self-interest: those loans account for 17% of its portfolio. In bucking the general disdain for bailing out investment properties, Ocwen realizes that cash is cash, whether it comes from an owner-occupied mortgage payment or one fed by rent, and that a foreclosure displaces a family and blights a neighborhood whether the occupants are owners or tenants.

Which just goes to show that money-making and good economic policy aren't necessarily incongruous. As much as capitalism—especially in the mortgage industry—has gotten a bad rap of late, it might just prove useful yet. ■

### 3 The secret formula.

If your ability to pay has truly changed, your servicer might consider a modification. That depends on whether it can get more money out of you or from a foreclosure.



### 4 Keeping payments coming.

Changes to your loan—like an interest-rate reduction—will be designed to get as much money from you as possible without causing you to default.



### 5 The investors must be happy.

Most recent mortgages were packaged and sold to investors. As long as the servicer keeps cash flowing from the loans, it can probably keep modifying.







BARBARA P. FERNANDEZ FOR THE NEW YORK TIMES

Luzetta Reeves, with her grandson Donnie Howard, now makes a lower monthly payment on her house in Miami Gardens, Fla.

## Modifying Mortgages Can Be a Tricky Business

By VIKAS BAJAJ  
and JOHN LELAND

MIAMI GARDENS, Fla. — When her brother could no longer help support her, Luzetta Reeves asked her small mortgage company to cut her monthly payments. It did — by 11 percent — making it possible for her to afford her house here on her modest fixed income.

In Miami, Jeffrey Mitchell saw his family income drop just as real estate taxes and insurance premiums increased, making his monthly mortgage payments crushing. He got a lower interest rate, too. But with the added fees and penalties, his monthly payment remained the same. He is now back in foreclosure.

As the Obama administration steps up efforts to help troubled homeowners modify their mortgages, it might consider the experiences of these two South Florida borrowers and their mortgage companies, one small, one large.

National statistics on mortgage modifications suggest that what happened to Ms. Reeves, a disabled 54-year-old, and Mr. Mitchell, a 42-year-old union representative, is fairly typical.

The nation's 14 largest banks reported that more than half of the loans they modified last year

were delinquent again after just six months, according to the federal bank regulator, the comptroller of the currency. But several small mortgage companies like the one that helped Ms. Reeves, which have been pursuing modifications longer, say that less than 25 percent of their modified loans became delinquent again.

"It's becoming more and more clear to us that if you do real modifications the default rate is significantly lower," said Tom Miller, the attorney general of Iowa, who has led a group of state officials pushing the industry to modify more loans. "They shouldn't be called modifications

if people pay more or approximately the same."

Two years into the foreclosure crisis, many borrowers say they still have trouble reaching anyone at their bank or mortgage company to discuss loan modifications.

Banks and investors absorb huge losses in foreclosures, but some mortgage companies may view foreclosure as more profitable and expedient than modifications because they can levy extra fees and they do not have to wait to see if a homeowner will continue to make payments.

Bankers counter that they pur-

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# Modifying Mortgages Can Be Tricky Business

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sue options that minimize losses, but add that it is often hard to reach delinquent borrowers because many hide from their creditors.

While both arguments appear to have merit, reports by analysts at Credit Suisse and a law professor, Alan M. White, show that when mortgages are renegotiated, borrowers often face higher monthly payments or balloon payments at the end of the term.

Rod Dubitsky, a mortgage analyst at Credit Suisse, found that modifications that result in lower payments tended to re-default at half the rate as plans under which payments were higher or remained roughly the same.

The performance of individual companies varies greatly. Some, like Wells Fargo, one of the nation's largest servicers of home loans, have modified few loans as a percentage of their delinquent mortgages, said Mr. White, an assistant professor of law at Valparaiso University.

Other companies like Ocwen Financial and Litton Loan Servicing, a subsidiary of Goldman Sachs, have modified a big portion of their delinquent loans, according to Credit Suisse. (The studies cover only loans packaged into securities, not those held on the books of banks.)

In the case of Ms. Reeves, Ocwen cut the interest rate to 5.6 percent, from 8.9 percent, lowering her payments by \$125, to \$1,027. Officials at the company said the reduction would cost less than seizing and selling Ms. Reeves's modest two-bedroom house near Dolphin Stadium.

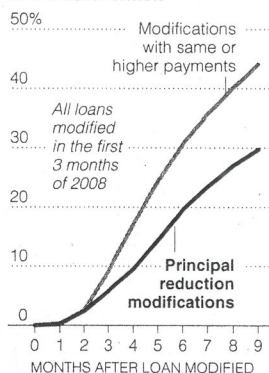
"Ocwen was very patient with

Vikas Bajaj reported from Miami Gardens, and John Leland from New York.

## Not All the Same

Lenders have been modifying delinquent home loans, but the borrowers making the same or higher monthly payments fall behind again faster than those who pay less after their principal has been reduced.

### LOANS 60 DAYS OR MORE PAST DUE AFTER MODIFICATION

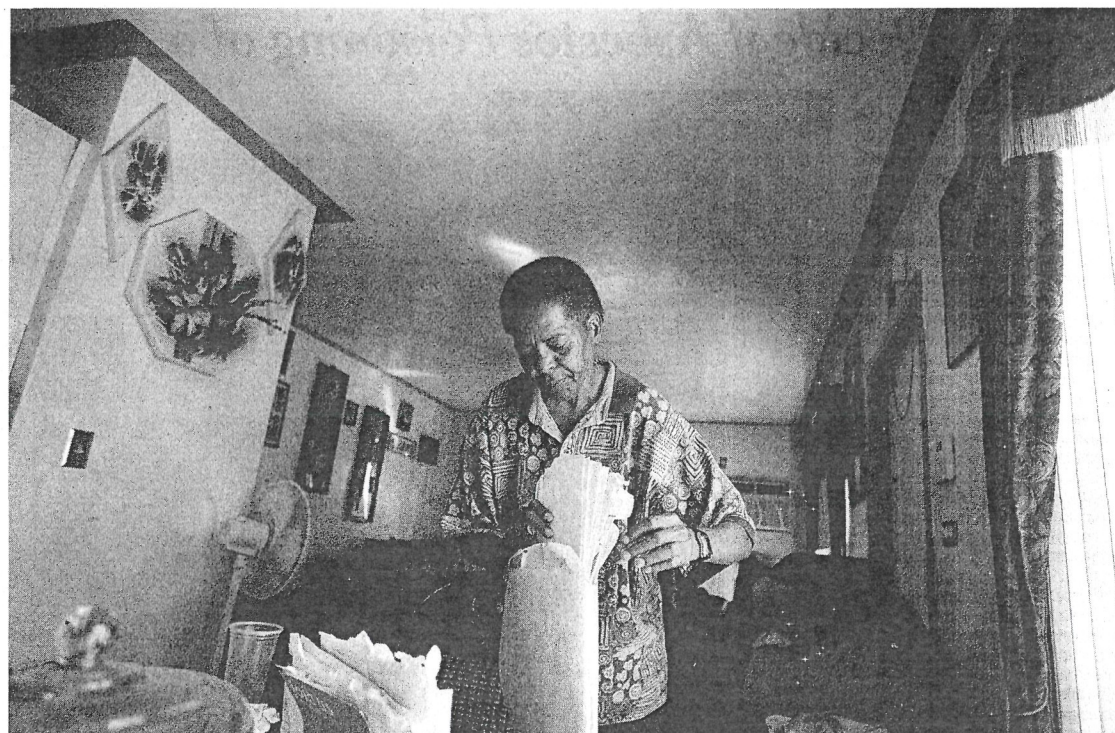


Source: Credit Suisse THE NEW YORK TIMES

me, and they really worked with me," said Ms. Reeves, who has back problems and breast cancer.

The company said its modifications were not acts of charity but were based on calculations of whether changing loan terms was in the best interests of investors. Using home price data, estimates of legal costs and the time it takes to foreclose, the company determines how much it will recover in foreclosure. It compares that with estimates of what borrowers can afford based on income, family size and expenses.

"Our biggest hurdle is reaching out and talking to people," said Margery A. Rotundo, Ocwen's senior vice president for residential loss mitigation. "If a



BARBARA P. FERNANDEZ FOR THE NEW YORK TIMES

Luzetta Reeves was able to remain in her home by modifying her mortgage, which cut her interest rate to 5.6 percent from 8.9.

borrower has a desire and the ability to stay in the home, we can help them."

Ms. Rotundo said the company's decades-long experience with borrowers with blemished credit histories informed its approach.

Ocwen, which is based in West Palm Beach, Fla., modified half of the delinquent loans it resolved last year. It foreclosed on a third, and most of the rest were sold before foreclosure for less than what was owed on them.

But many more people appear to have the experience of Mr. Mitchell, the other Florida borrower.

Mr. Mitchell bought his Miami home four years ago for \$282,000.

In 2007, his wife had to work less to care for a sick child, and the family was hit with higher tax bills and insurance premiums, raising monthly payments to \$2,700 from \$2,200.

When Mr. Mitchell told Wells Fargo he could not keep up, he said, "It fell on deaf ears for a while."

Wells Fargo ultimately cut Mr. Mitchell's interest rate to 6.1 percent, from 6.5 percent. But it added fees, back payments and penalties to his principal, raising it above \$300,000. His payments were virtually unchanged, and he was asked to make a \$5,000 payment to get out of foreclosure. He fell behind again right away. His house, he estimates, is worth

only \$199,000.

"The arrangements they come up with are not really in your best interest," he said. "You feel like you're trapped."

Wells Fargo declined to comment for this article.

Analysts say it is hard to know exactly why different mortgage companies handle delinquent loans so differently.

Smaller companies like Ocwen that are under more financial pressure and have more experience in dealing with higher-cost loans have been most aggressive in lowering payments, said Mr. Dubitsky, the Credit Suisse analyst. Big banks like Wells Fargo, which would need to be retooled to emphasize modifications over

foreclosures, appear to favor modifications that do not lower payments or debts very much.

A spokesman for the comptroller, Bryan Hubbard, said that many banks began focusing on lowering monthly payments last year and that it would be premature to say they had not done enough to help borrowers.

Lowering payments is becoming more important as the economy weakens, Mr. Dubitsky said, because more borrowers are likely to lose jobs or encounter expenses they cannot afford.

"If the borrower is spending every last dollar on their debt," he said, "that leaves them vulnerable to unexpected expenses."